FEBRUARY 27, 1984 THREE DOLLARS

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Forbes

CALIFORNIA'S DEUKMEJIAN

HOW TO TAME A BEASTLY BUDGET

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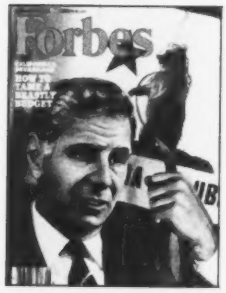

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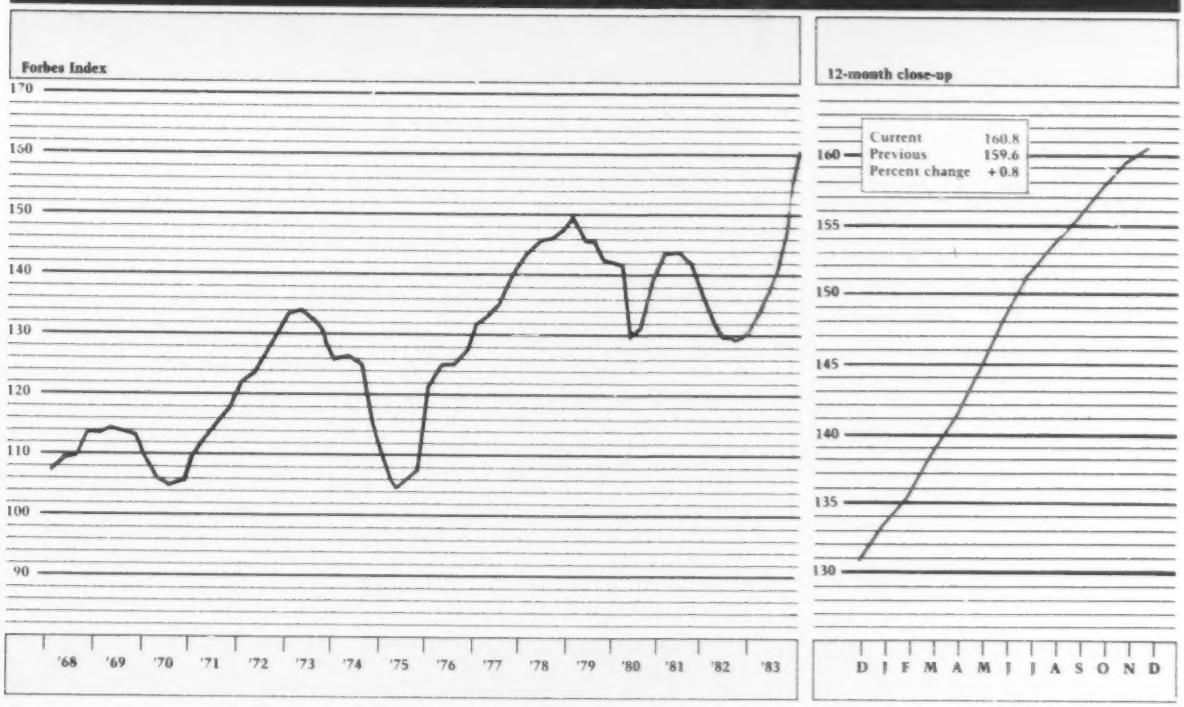
The Forbes Index



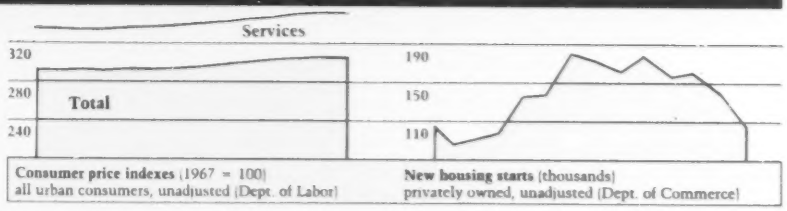
Harder to climb. After being on an upward track for more than a year, the Forbes Index is definitely slowing down. Manufacturers' new orders, for example, were up 0.2% from November and are some 26.2% higher than they were in December of 1982. But compare this with a 3.4% rise from October to November and a 36.7% gain from November of 1982 to November of 1983. While orders were slowing, however, inventories were still held in check. They are up only 0.1% from November to December, vs. a 0.2% rise from October to November.

In the latest reporting period, the Consumer Price Index rose 0.1% from the previous month. But the service component of the Index was up nearly twice as much as the overall figure.

The Forbes Index Components

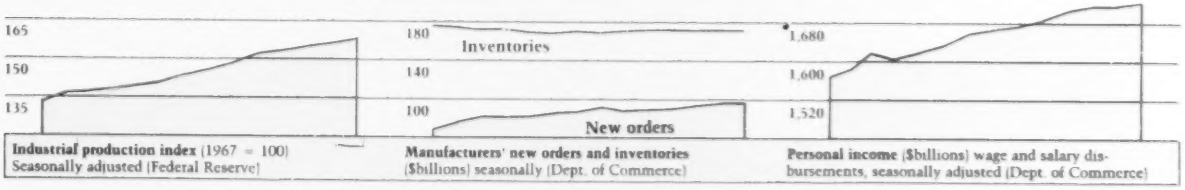
The FORBES Index is a measure of U.S. economic activity composed of eight equally weighted elements. Total industrial production, new claims for unemployment compensation, the cost of services relative to all consumer prices, the level of new orders for durable goods compared with manufacturers' inventories, total retail sales, new housing starts, personal income, total consumer installment credit.

To measure these eight elements, FORBES monitors ten series of U.S. government data. The last 13 months' data for each series is presented at right.



Consumer price indexes (1967 = 100) all urban consumers, unadjusted (Dept. of Labor)

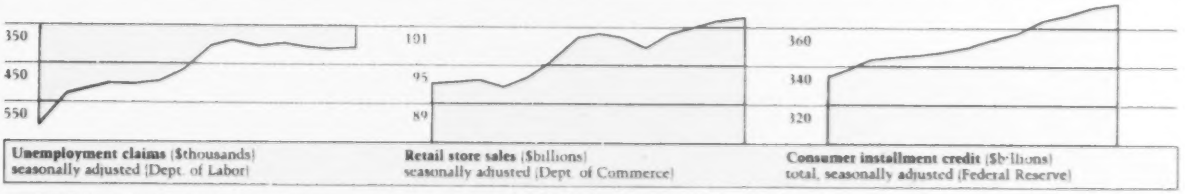
New housing starts (thousands) privately owned, unadjusted (Dept. of Commerce)



Industrial production index (1967 = 100) Seasonally adjusted (Federal Reserve)

Manufacturers' new orders and inventories ($billions) seasonally (Dept. of Commerce)

Personal income ($billions) wage and salary disbursements, seasonally adjusted (Dept. of Commerce)



Unemployment claims ($thousands) seasonally adjusted (Dept. of Labor)

Retail store sales ($billions) seasonally adjusted (Dept. of Commerce)

Consumer installment credit ($billions) total, seasonally adjusted (Federal Reserve)

There is no law against Dow Jones' plan to create two classes of stock. But that doesn't mean there are no penalties.

Class struggle

By Pamela Sherrid

A FEW WEEKS AGO Dow Jones directors voted to join the growing number of firms that have two classes of stock with equal claim on assets but unequal voting rights. The purpose of such arrangements, which typically involve series A and series B shares, is to help controlling shareholders stay in control. That is clearly the case at Dow Jones. The Bancroft family—heirs of Clarence Barron—owns 56% of the equity.

The objective here is hardly new. A special class of stock that elects, say, three-fourths of the board, has long been a fixture at family-dominated media companies. The New York Times Co. and the Washington Post Co. both have such provisions. There is a difference, however, between telling shareholders from the start that they are second-class citizens and handing out limited voting stock to existing minority shareholders.

To begin with, battening down the hatches affects marketability. When Dow Jones gets two classes of equity it must leave the New York Stock Exchange—as A.O. Smith and Figgie International did last year when they instituted similar plans. The problem is that while such arrangements can make sense for management, they are not always popular with investors.

Most of the potential problems involve the rights of minority shareholders. "We don't like any situation in which one owner is at a disadvantage to another," says an official of the New York Stock Exchange. "There is a potential for abuse." Having special stock strengthens the ability of insiders to make acquisitions from other insiders, issue themselves handsome stock options or sell cheap shares to friendly parties.

The biggest financial loss to outside shareholders, however, is the right to be bought out at a premium in an unfriendly takeover, the very event that the insiders are seeking to avoid. When insiders do decide to sell, what's more, the control that they have protected can be very valuable indeed.

Consider the sad tale of National Old Line, an Arkansas insurance company. Its founding family controlled most of the Class A voting shares but only 11% of total equity. The rest was held by the public through nonvoting B shares. These had equal rights at liquidation, but not, as it turned out, in the event of a sale.

A few years ago a Dutch insurance company came courting. The family was willing to sell for $80 a share, over $300 million. The Dutch bidder offered $144 million. So the family took $80 for its stock and gave other shareholders what was left. That amounted to $26.75 per share. Class B shareholders sued. Eventually, they settled for $28, which forced the family to cut its price to $67.80.

To avoid these hassles, the NYSE

Almost all in the family

These companies use unequal voting provisions to insure control by corporate insiders. As a result, public shareholders may be penalized if there are fat takeover premiums.

Company	Control stock	Control mechanism	Control group	Control stock held
Blount	Class B	Elects 75% of directors	Blount family	60%
Brown-Forman Distillers	Class A	Class B nonvoting	Brown family	62
Charter Medical	Class B	Elects 75% of directors	W.A. Fickling	83
International Bank	Common	10 votes per share	G. Olmsted	36
Media General	Class B	Elects 70% of directors	D.T. Bryan	59
AC Nielsen	Class B	Class A nonvoting	Officers and directors	56
New York Times	Class B	Class A limited-voting	Ochs Trust	78
Saunders Leasing	Class B	Elects 75% of directors	Saunders family	56
AO Smith	Class A	Elects 75% of directors	Smith Investment Co	54
Wang Laboratories	Class C	Elects 75% of directors	Wang family	69
Washington Post	Class A	Class B limited-voting	K. Graham and trusts	100

bans all companies with two classes of stock—except for Ford Motor Co. Its special shares get 40% voting power though they comprise less than 10% of the equity, a situation that existed before the current restrictions were imposed. NASDAQ officials aren't troubled by differing classes of stock, but the American Exchange has a logical middle ground:

- Limited-voting shareholders must have the right, voting as a class, to elect not less than 25% of the board. In many situations, this gives minority shareholders more of a voice in the firm than they already had.
- In all matters other than electing the board, the voting ratio in favor of so-called supervoting stock cannot be greater than 10-to-1. "If a company continues to grow and issue shares, then ultimately the public will get the dominant vote," explains Amex Senior Vice President Robert Smith.
- Insiders can't do anything that would diminish the voting power of the limited-voting stock, such as creating for themselves yet another class of supervoting paper.
- Even with these rules, however, one share of supervoting stock could still elect 75% of the board. To prevent that, the Amex wants supervoting shares to lose their clout when they fall below 13% of total equity.

The exchange also makes a recommendation: That insiders pay a preferential dividend on limited voting shares. The idea here is that shareholders are giving something up with their reduced votes and should be compensated.

Dow Jones is offering no such carrot. In addition, its outside shareholders are prodded with a rather heavy stick. Unlike other companies that allow a public market to develop in both their heavy-voting and light-voting shares, Dow Jones will allow its heavy-voting shares to be transferred only within a shareholder's family.

So, when a family member sells to an outsider, his heavy-voting shares will have to be converted to publicly traded limited-voting shares. "The illiquidity of the heavy-voting stock encourages conversion and will actually increase control by the Bancroft family," explains a NYSE official.

Does anybody care? Dow Jones stock fell about 15% after it disclosed the plan. "Most of that fall was due to the announcement," says Ken Noble of Paine Webber. One reason is that many institutional investors, which held over 25% of Dow Jones' shares, avoid illiquid stocks.

Well, nobody ever said insurance is cheap. ■

Taxing Matters

Politicians are convinced that tax-motivated mergers are immoral. But they haven't figured out how to stop them.

Losers keepers

By William Baldwin

ALAN WURTZEL, a lawyer turned retail executive, found a nice bargain three years ago in bankruptcy court. Wards Co., his $317 million-a-year electronics retailer, bought the failed Lafayette chain for $6.8 million in stock and assumed liabilities. The prize: a foothold in the New York City market, leases worth $5 million and a fat $37 million in accumulated tax losses.

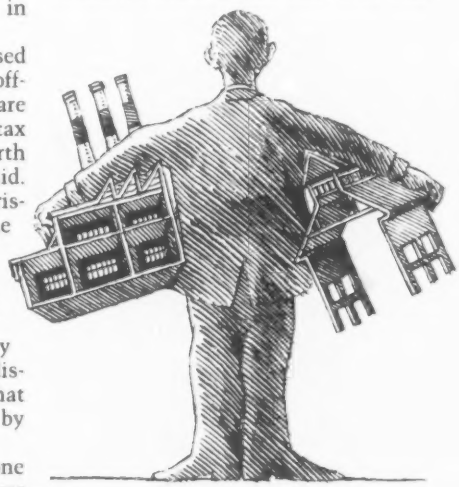
Because profits at Virginia-based Wards have been large enough to offset Lafayette's former losses, these are particularly handy. That means tax savings from the purchase are worth more than twice what Wurtzel paid. Not surprisingly, Wards stock has risen from $1.65 to $13.25 since the deal went through.

Wurtzel isn't bragging about his bargain. "We didn't do it primarily for the tax benefit," he explains, with good reason. His ability to use Lafayette's tax losses will disappear if the IRS can ever show that the deal was primarily motivated by tax considerations.

This tax-motivation rule is one weapon in government's 30-year war against "trafficking" in loss carryforwards, a war that is currently escalating. Last month new rules, enacted in 1976 but repeatedly delayed because no one could figure how they work, went into effect. Three congressional committees are now rewriting the 1976 law with a view to making it tougher.

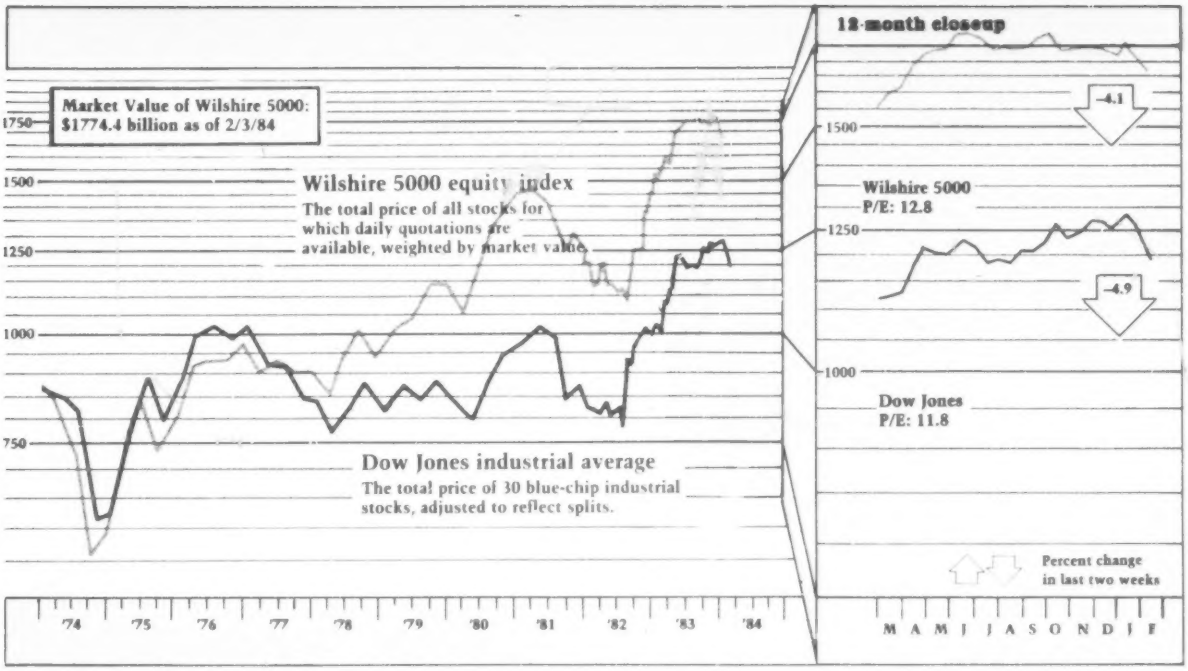
Part of the problem, however, is congressional ambivalence. Fairness demands the pooling of gains and losses, say the legislators. A corporation that loses money one year and makes it back the next, or loses in this division what it makes in that one, should pay no taxes. But this approach to taxation inevitably encourages mergers, something that makes politicians uncomfortable.

All this brings business for tax planners and buying opportunities for their clients. Thanks to the uncertainties, a dollar of loss carryover will



cost an acquirer maybe 5 cents, says Bear, Stearns partner Randall Smith, even though it can save up to 50 cents in federal and state taxes. Such value is particularly attractive to aggressive investors such as Chicago's Pritzker family, which may have picked up several hundred million dollars in potentially valuable Braniff Airlines loss carryovers for next to nothing, and Cincinnati's Carl Lindner, who controls the New Haven Railroad's $58 million tax-loss carryforward.

The Forbes/Wilshire 5000 Review



Wintertime blues. Wall Street started the new year on an emotional high, but in only a few weeks investors went from euphoria to deep depression. Much of this anxiety stems from the Administration's latest budget proposal and its forecast for gigantic deficits. The Dow industrials, driven down by sharp declines in bellwether blue chips such as IBM and General Motors, are off 4.9% for the latest two weeks and 7% for the month. Amex issues suffered 5.9% and 6.3% falls, respectively, for the most recent two- and four-week periods. Shares trading over-the-counter were hit with the hardest losses, 7.2% for two weeks and 8.3% for four weeks.

After the recent market decline, many leading indicators show discouraging 52-week performance, despite an economic turnaround and sharp increases in corporate profitability. The NASDAQ index is only 4.9% higher than it was 12 months ago, while the NYSE is up 10.3%. The Amex shows the best performance, with a 16.6% gain. Meanwhile, the Wilshire is 9.5% higher than it was last year. But, with a 5.8% drop in the most recent month, the price/earnings multiple on the Wilshire is down from 14 at the start of the year to 12.8 at present. If stock prices continue to fall it won't be long before many issues, once again, are back on the bargain table.

Close-up On The Equity Markets

Performance of six leading indexes

Percent change	Wilshire 5000	Forbes 500[1]	Dow Jones industrials	NYSE Composite	Amex Market Value Index	NASDAQ Composite
	-5.8	-3.2	-7.0	-4.8	-6.3	-8.3
in last 52 weeks	9.5	12.2	11.1	10.3	16.6	4.9

Stock performance based on five key investor yardsticks

Percent change	Company size		Volatility[2]		P/E multiple		Dividend yield		Growth profile[3]		Share price	
	large	small	high	low	over 25	under 5	over 7.5%	none	high	low	over $40	under $4
in last 4 weeks	-6.2	-0.1	-4.4	-0.4	-8.0	-1.2	-0.3	-3.6	-1.7	-0.6	-5.2	-1.1
in last 52 weeks	11.6	42.5	28.6	22.1	12.3	40.5	23.5	34.9	29.0	24.3	21.6	32.5

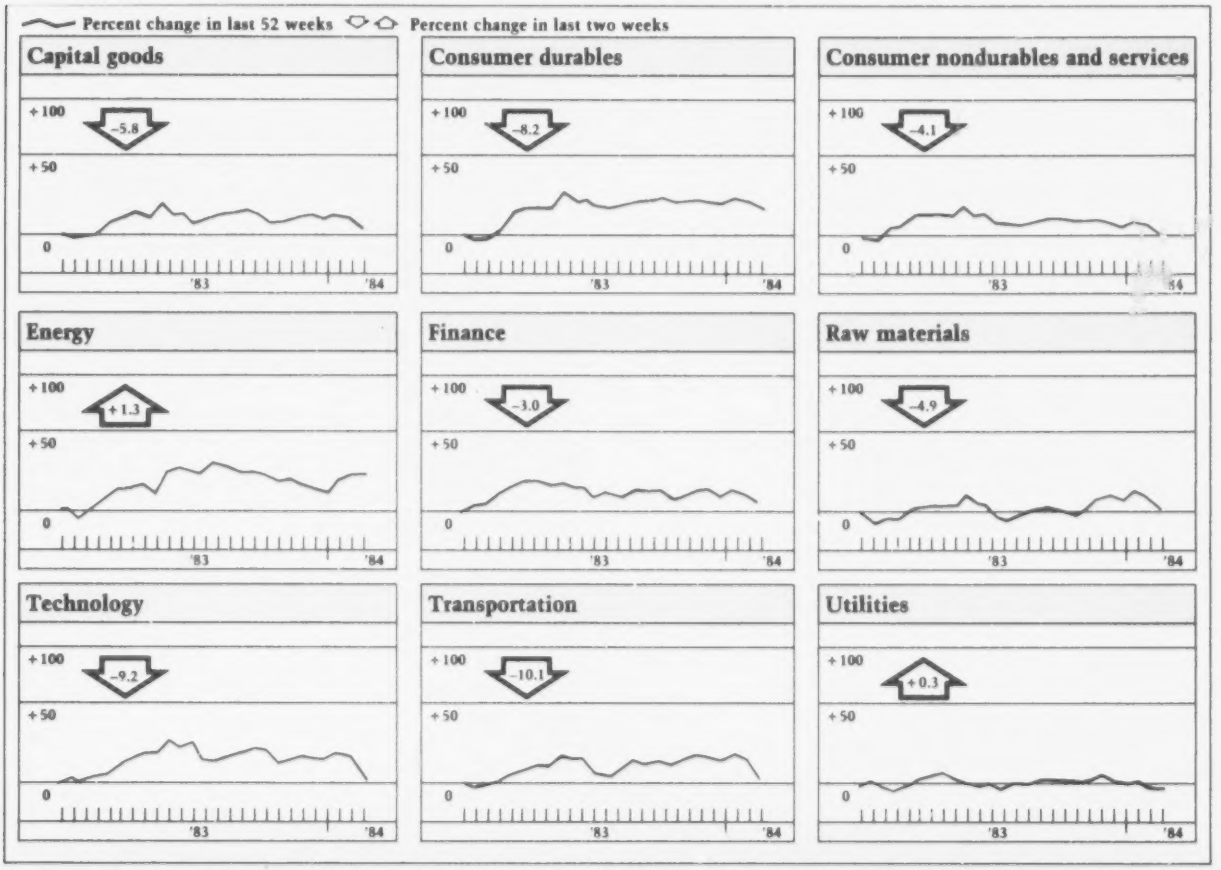
[1]Based on sales.
[2]A stock's sensitivity to overall market movement. High volatility issues have wide price fluctuations; low volatility issues are more stable.
[3]A quantitative evaluation of a stock's growth image, determined by Wilshire Associates.

Note: All data for periods ending 2/3/84. Prepared by Wilshire Associates, Santa Monica, Calif.

Where The Action Is

Love in vain? A few weeks ago many experts were talking about an everlasting romance on Wall Street. So the sharp declines in the last several sessions came like a slap in the face. With IBM showing a one-month drop of almost 13 points, the technology group was hit hard, with losses of 9.2% and 12.5% for two weeks and four weeks, respectively. Transportation shares show the second-worst four-week performance and the worst two-week decline. A number of major airline and trucking stocks suffered multiple-point losses. Consumer durables, with a 9.2% drop for the month, was the third-poorest performing sector.

During the last two weeks only two groups—energy and utilities—gained ground. Further merger speculation pushed up the large oils, while investors shopping for power companies with little or no nuclear exposure helped the utilities to rise.



What The Analysts Think

Signs of decay. Over the last two weeks analysts have scaled back their earnings estimates on seven of the nine Wilshire sectors. While transportation and consumer durables now show larger estimates, both sectors registered large two-week losses. Meanwhile, The Forbes 500s is now selling at less than 7 times estimated 1985 earnings.

Forecasting the Forbes 500

Performance period	Average earnings per share	P/E
latest 12 months	$2.52	13.4
1984 estimates	4.33	8.6
1985 estimates	5.41	6.9

Rank based on change in estimate	Sector	Estimated 1984 EPS	% change in 1984 estimate in 2 weeks	in 4 weeks
1	Transportation	$3.16	1.22%	-1.85%
2	Consumer durables	3.81	0.33	0.35
3	Utilities	3.70	-0.70	-0.70
4	Technology	2.17	-0.84	-1.40
5	Finance	4.68	-0.90	-1.36
6	Consumer nondurables	2.97	-1.05	-1.69
7	Raw materials	3.67	-1.40	-2.25
8	Energy	2.78	-1.69	-3.26
9	Capital goods	2.48	-3.89	-1.38

Earnings projections are equal-weighted consensus estimates from over 1,800 security analysts. Forecasts for the 9 Wilshire sectors are limited to firms with 3 or more estimates, with a mean estimate greater than $0.50. Data are compiled and updated weekly by Zacks Investment Research, a Chicago-based quantitative consulting firm.

Note: All data for periods ending 2/3/84. Prepared by Wilshire Associates, Santa Monica, Calif.; Zacks Investment Research, Inc., Chicago, Ill.

Statistical Spotlight

Drug stocks were sickly in 1983. Will healthy earnings this year give them the shot in the arm they need?

The road to recovery

By Leslie Pittel

DRUG STOCKS need a booster shot. Even though their 18.5% average return on equity is sky-high, these companies were market laggards in 1983. "The industry is at the lowest P/E relative to the overall market that I've seen in ten years," says Frederic Greenberg, a vice president at Goldman, Sachs & Co.

Heavy foreign exposure and new federal health care policies put drug companies in Wall Street's sickbed. But not everyone sees symptoms the same way. Traditionally, a strong dollar hurts the industry, which has big overseas sales. But Steven Leuthold of The Leuthold Group in Minneapolis argues that a cure is on the way. "There is more currency hedging today and less vulnerability," he says.

Then there are the recent Medicare/Medicaid amendments, which set prospective reimbursement schedules for hospitals. In order to stay within their budgets, institutions will have to cut costs, and pessimists think they might do this by using less expensive drugs. But there's a counterargument here, too: "Since labor makes up 70% of their costs, hospitals will try to get patients out as soon as they can," says Dorothy Eckardt at Butcher & Singer. To prevent potential malpractice suits, doctors might prescribe additional medication to treat their outpatients.

Over the long term, of course, changing demographics give the drug industry the most important plus. "Remember, older people are bigger consumers of drugs," says Leuthold.

One word of caution: While drug stocks as a group are relatively risk-free, individual stocks can rise or fall based on one key product. Look at Eli Lilly. Litigation relating to Oraflex, its antiarthritis drug, has pushed share prices to 1972 levels even though earnings have more than tripled since then. Leuthold likes Lilly now, but he also recommends holding several drug stocks to limit the one-

Pill Street blues

Most of these ethical drug stocks are trailing the overall market. But with above-average returns on equity and robust earnings estimates for 1984, they may have healthy futures.

Company	Price recent	Price 52-week high–low	200-day performance vs market	Price/earnings latest 12 months	Price/earnings 5-year high	Price/earnings 5-year low	EPS latest 12 months	EPS 1984 est	Dividend	Return on equity
Abbott Laboratories	43⅞	53⅛–36½	94%	15.3	18.7	9.9	$2.86	$3.34	$1.00	22.1%
American Home Products	51½	54⅛–41¾	97	12.9	13.6	7.5	4.00	4.49	2.64	30.4
Bristol-Myers	43¾	47⅞–31^{3}/$_{16}$	113	15.1	18.5	8.7	2.89	3.45	1.20	20.3
Carter-Wallace	24½	29 –18	90	10.8	14.2	5.6	2.26	2.45	0.48	10.5
Erbamont NV	11½	25⅛–11½	NA	13.2	26.9	12.2	0.87	1.18	—	18.9
Eli Lilly	62	68⅜–56¼	97	10.6	17.2	9.2	5.87	6.77	2.90	20.0
Merck & Co	90	104⅝–81⅓	104	15.0	18.6	11.5	6.02	6.87	3.00	18.8
Novo Industries AS	55¼	73½–46¼	103	18.8	37.3	15.9	2.97	3.80	0.28	21.3
Pfizer	35¼	44½–33⅛	84	13.1	19.1	8.9	2.73	3.19	1.32	16.9
AH Robins	19	29⅛–16¼	88	8.0	14.8	3.9	2.37	2.75	0.68	15.2
Rorer Group	29	34⅛–22⅞	105	14.9	18.8	9.2	1.94	2.26	1.08	18.9
Schering-Plough	36⅞	48⅛–36	82	10.7	14.2	5.6	3.45	3.85	1.68	13.8
GD Searle	45¼	55⅞–34¼	112	19.0	20.2	7.6	2.38	3.40	0.52	21.1
SmithKline Beckman	57½	76½–55¼	83	9.8	17.9	9.4	5.85	6.41	2.80	24.7
Squibb	47⅜	55⅝–38¼	86	14.8	60.8	9.7	3.20	3.76	1.44	14.0
Sterling Drug	26	29⅜–22¼	99	11.9	14.5	8.6	2.18	2.48	1.12	15.3
Syntex	48	62½–47⅛	79	10.8	17.9	7.1	4.44	4.84	1.40	24.4
Upjohn Co	56½	68½–49¼	101	11.3	16.4	6.3	4.99	5.89	2.56	12.9
Warner-Lambert	31¼	35 –26⅛	86	13.7	17.1	6.7	2.28	2.84	1.48	11.8

NA: not available

Sources: Media General by Business Information Systems, Institutional Brokers Estimate System (IBES), a service of Lynch, Jones & Ryan, Forbes

bad-product risk.

The table on page 186 lists 19 major ethical drug companies. Some are selling below the overall current market P/E of 12.8. Most should show higher 1984 earnings. In addition, for the past 200 days most of the stocks have underperformed the market, as indicated by the below-100 values in the performance index column.

"We think that we've seen the bottom of these stocks and that their relative performance will improve," says Greenberg. "Values here look really good." ■

The Funds

The hot stock funds have cooled while the cool stock funds are getting hot.

Switch in mood

By Barbara Rudolph

ONE OF THE MUTUAL FUND industry's surprising 1983 successes was the T. Rowe Price Growth & Income Fund. Set up one year ago to invest in a mix of fixed-income securities and large cap and high-yielding stocks, it now has $260 million in assets, with almost no quick redemptions. "I don't know that we've ever introduced a fund with a first year that good," says Price spokesman Steven Norwitz.

Good-bye hot stock funds, hello income-and-capital preservation. In keeping with the current mood, investment managers are promoting some recently ignored funds. Aside from high-risk products, like small-company growth funds, in the back of the shop there is less showy merchandise. Growth and income fund managers seek what their title suggests—a combination of dividend income with a modest level of capital appreciation.

Look at Fidelity, among the most savvy of marketers. There are now fewer ads for its aggressive Magellan Fund and more for the straightlaced Equity-Income Fund. No wonder: While Magellan's 1983 sales were about 3 times those of Equity-Income's, that gap was closing fast in January. Three months ago Fidelity also slyly added a 2% sales charge to previously no-load Equity-Income.

Why the switch to caution? No secret: The more conservative funds were up slightly during the tricky last quarter of 1983. By contrast, the more aggressive capital appreciation and growth funds were down an average of 3% for the quarter. ■

Going for income and growth

These 40 growth and income funds have at least $100 million in assets. Each fund is rated in FORBES' annual fund survey.

Fund	1-year return	5-year return	FORBES rating UP	DOWN
Affiliated	25.8%	152.8%	C	C
American Birthright Trust	20.7	130.0	C	C
American Mutual	24.4	164.6	D	B
Bullock	15.9	118.5	C	C
Decatur Income	23.0	154.7	D	B
Delaware	15.4	185.7	D	C
Dividend Shares	20.7	109.0	D	D
Dreyfus	19.8	136.4	C	C
Fidelity	22.5	153.0	C	C
Fidelity Equity-Income	29.2	229.2	C	A
Fidelity Puritan	25.8	148.5	D	A
Financial Industrial	14.5	137.2	C	C
Founders Mutual	25.1	107.6	D	D
Fund of America	28.2	251.7	C	D
Fundamental Investors	26.3	133.9	D	D
Guardian Mutual	25.3	176.0	B	C
Hamilton	9.9	80.3	C	F
ISI Trust	6.6	67.8	D	A
Income Fund of America	17.4	111.5	D	A
Investment Co of America	20.3	134.6	C	C

Fund	1-year return	5-year return	FORBES rating UP	DOWN
Investors Stock	15.9%	110.7%	D	D
Istel	17.0	103.0	C	D
Mass Financial Devel	22.4	180.4	B	F
Mass Investors Trust	20.9	117.8	B	F
Merrill Lynch Capital	23.1	155.9	D	F
Mutual Shares	37.0	188.7	B	B
National Stock	9.4	112.5	D	C
Nationwide	15.8	87.0	D	C
One William Street	23.8	168.1	C	D
Penn Square Mutual	29.8	144.3	C	C
Philadelphia	18.4	118.0	C	C
Pioneer	24.9	129.9	C	D
Pioneer II	30.0	195.8	B	B
Security Investment	10.1	120.5	D	C
Seligman Common Stock	27.2	159.6	C	D
Sentinel Common Stock	20.2	147.6	D	B
State Street Investment	19.6	115.6	C	D
Value Line Income	6.7	160.6	D	A
Washington Mutual	26.3	159.7	D	B
Windsor	30.2	178.0	C	B